



ON

RAILWAY FEDERATION.

THE

PROPOSED RAILWAY TRUSTS.

BY

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OF THE NEW YORK BAR.

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I.

THE PROPOSED RAILWAY TRUSTS.

THE revival of discussion concerning a railroad trust, or an inter-association of such trusts in the various sections of the country where it is supposed they might be useful, is, perhaps, a natural result of the conceded failure of State and federal legislation, on the one hand, and of the several voluntary associations among railways or railway officials, on the other, to solve satisfactorily all the problems that are involved in railway operation and management in this country. We have tried State statutes and Federal statutes, State boards of railroad commissioners, Interstate Commerce Commissions, Interstate Commerce Railway Associations, Granger legislation, Trunk-line Pools, Traffic Associations, Judge Cooley and Mr. Fink, all without avail, and we begin to perceive either that the railways must contrive some new, effective, stable and equitable control of themselves, having due regard to the interests of the public and of the owners of the property involved, or that we shall presently end in absolute governmental ownership and operation.

We have learned that railways without regulation will not be tolerated in this country; that

legislation of the sort hitherto attempted does only a little good and a great deal of harm; that associations between railways themselves, or among railway officials, being only palliatives and make-shifts, are inherently too weak to serve either the railways or the public efficiently; that the progress of consolidation of lines can neither be swift nor sweeping enough to answer the purpose, and we now discover that, in midsummer, 1889, having wasted our substance on many physicians, we are little better off than we were twenty-five years ago. We have, indeed, made some progress since the early days when the public had no rights that a railroad was bound to respect, and since that later time when railroads were pillaged and plundered by the public as though they were a common enemy; but we are still in a wretched predicament, and very far from a condition of railroad operation which secures to the public all it ought to have and preserves to the railways all they are entitled to. The railways must, therefore, set about in good earnest to devise a remedy or we shall presently be face to face with governmental operation. It is idle to cry peace, peace, when there is no peace. This is precisely the turn that railway affairs in the United States are now taking.

The proposition to operate railways by means of an association between the shareowners of connecting, parallel or competing lines—associations between the railways themselves, or their officials, having proved ineffectual—is, in this view of the

situation, entitled to the mast intelligent consideration. It is the purpose of this essay to suggest some things to be avoided in the creation of such an association, and to propose some objects desirable to be attained thereby.

If on consideration it be determined that voluntary, unincorporated associations between the share-owners of certain railways are desirable—that is, that railway trusts are desirable—let us begin by not calling them “trusts.” The public are possessed of an unreasoning dread of what they call “trusts,” and the public temper is in a feverish state regarding them. Not one man, indeed, in a thousand, who is in a state of consternation over “trusts,” knows what a trust really is, or how it is constituted, or what it is designed to effect, or what it actually accomplishes. He has been taught his terror by the newspapers and the politicians. Seven hundred and fifty out of the thousand will, when trusts are explained to them, cease to regard them with alarm. The remaining two hundred and fifty are possibly incorrigible. They are not, however, this time Matthew Arnold’s “redeeming minority,”—on the contrary, quite the reverse. In christening the railway trust it will then be wise to take due account of this condition of the public mind, and it will be a step in the right direction to quit calling it a “trust.” It may be called anything but that. If it be called an association, or a voluntary association, or a voluntary unincorporated association the public will

not be scared. When an organization, not indeed created on the trust theory, but designed, as towards the public at least, to accomplish in some respects very much the same ends contemplated in the creation of trusts, was lately called the "Interstate Commerce Railway Association," no one was seriously disturbed, and nobody shouted "conspiracy" or "stop thief." The partisan newspapers also who, in one column were bawling out vituperation of "trusts," on another page gleefully make small jokes over what they called an "agreement among gentlemen." They were so taken with their wit that they entirely overlooked what they might have called the "trust" iniquity that lurked in it. Witness also the persistence with which they miscall the North American Salt Co. a "trust." It will, in this state of the public intelligence and temper, be wise to throw it a sop in the matter of the name for the railway trust.

It may also be well to avoid any attempt at secrecy in the formation of such a trust. It is neither foolish, nor wicked, nor in any degree unlawful for stockholders to organize themselves in the way here proposed, and there is, therefore, no motive for any elaborate effort to conceal what is proposed. The commercial trusts, some of them, made a mistake in trying to cover up their organization. While, perhaps, it is, strictly speaking, no outsider's business how or why a trust of this sort is entered into, nevertheless, if any outsider thinks it is, and wants to see the wheels go around,

it will rob the "trust" of one of its terrors to be entirely open about it. It will be remembered that last winter it was strenuously urged that trusts are "secret," as if upon the theory that all other business undertakings among men are as open as the day; and there is, it will be conceded, some color of excuse, as people and politicians go, for popular outcry against any such enterprise which is at once novel and ostentatiously secret. Let the railroad trust, therefore, be formed just as other organizations are formed, without, on the one hand, any parade of details, and equally without any pass-words, grips, or countersigns.

Another matter to be especially insisted upon is that the trust certificates be not listed or dealt in on the floor of any Exchange here or abroad. If railway managers propose in good faith to organize a trust to promote legitimate railway operation, and are willing to conduct their business in the public interest and for the profit of the owners of the property entrusted to them, they will incorporate this provision as a cardinal principle in their deed of trust. The functions of a railway manager and of a gambler in railway securities are not compatible, and there should be no possibility and no temptation to unite them in respect of these trust certificates. Legitimate railway management imperatively requires that the manager of a railway keep out of Wall Street, at least so far as the securities of the road he manages are concerned. It is his sole function to operate his road and to

discharge the trust committed to him as a business man, and not as a bull or a bear on the Stock Exchange. The declaration of trust, then, should arbitrarily prohibit the listing of these certificates on any stock exchange. Any railway official who opposes this feature of a railway trust is primarily a stock speculator, and only incidentally a railway manager; and such a man is not a safe adviser in regard to railway policy.

Approaching the matter of the formal organization of such a trust, account must be taken, first, of the public or semi-public functions imposed by rules of law and public policy upon common carriers; and, second, of certain particular disabling requirements of law affecting railway corporations, a violation of which must be scrupulously avoided. The association contemplated must be entirely between the individual stockholders or stock and bondholders, and not at all between the railway corporations themselves. The corporation must be absolutely independent of the trust, and wholly separate and apart from it.

In formulating the scheme regard must be had to the rule of law that one railway company cannot vote on the stock of another railway company. It may sometimes lawfully acquire the stock of another road, and it may then lawfully hold it and receive dividends on it; but it is becoming a well settled rule that it cannot vote on it at corporate meetings, either directly or through the medium of trustees. There is already ample authority for

this position, and there will be more before there is less. The courts of chancery are setting their face against this form of control of one railway by another, and it cannot enter directly or indirectly into any feasible scheme of railway association.

Again, the courts have decided that the right to vote on railway shares cannot by proxy be irrevocably separated from the ownership. There can be no such thing as an irrevocable proxy to vote railway stock. This form of control of railway property has been tried over and over again, with all the possible variations, and has uniformly failed. The Cincinnati, Hamilton and Dayton, the Vanderbilt-Hostetter, and the Philadelphia and Reading voting trusts are recent instances of the inutility of such a device. Any scheme, therefore, to succeed, must wholly eliminate any contrivance of this nature. We must conceive something more enduring than an attempted irrevocable proxy.

It is as of course that any sort of a rope of sand will hold as long as there is no contest. What is now required is some form of association that will cohere in the face of a tempest, that can survive a lawsuit, and withstand the assaults and outlive the dissatisfaction of a minority in interest. We cannot, therefore, look to any scheme of railway consolidation, however plausible it may appear and however gigantic its proportions, as the solution of our present difficulties. The country is too large, the railways too numerous, and the legal and technical embarrassments too serious for such an under

taking to float Consolidation creates great systems, and is good as far as it goes; but it can never go in this country as far as it is necessary for something to go in order to relieve our railways from their present straits. The promoters of the monstrous scheme to consolidate the trans-continental lines by charter from the federal government which has lately been made the subject of some newspaper comment—if it have any substantial existence—will find out, even if they succeed, that their success is only another form of failure. If our territory were no larger than England and Scotland the scheme that furnished relief there might avail here; but railways in the British Islands are, as compared to our overgrown proportions, scarcely more than a laboratory experiment. We must also avoid any plan of association which, in the disposition of earnings, is obnoxious to the objection that it violates the provision of the Interstate Commerce law against pooling. This will possibly be the most difficult point to compass in drafting or devising a trust deed.

To specialists in railroad law and to laymen trained in this sort of speculation, these suggestions, many or all of them, will seem threadbare and commonplace, but there is a much more general lack of precise knowledge upon the matters here considered, even among railway men, than is perhaps generally believed. It is, therefore, safe sometimes to talk elementary principles. The following Associated Press dispatch, which re-

cently appeared in the morning papers, suggests the crudeness of many men's ideas on this subject:—

“CHICAGO, July 14.— The attorney for one of the largest railway companies having offices in this city, said to-day in regard to the proposed Railroad Trust:—‘ The injunction obtained against the Oregon Transcontinental Company, preventing it from voting its controlling stock at the Oregon Navigation election a month ago, following the decision refusing to allow the East Tennessee to vote its Memphis and Charleston stock, killed all hopes of a railroad trust ever being formed.’ ”

Of course “ the attorney for one of the largest railways ” never delivered himself of any such nonsense as that, and of course if he did he was the cow-case member of the firm, and might with equal wisdom have included in his citation of authorities the leading case of *Bardell v. Pickwick*, which is an excellent—and to the present writing unoverruled—authority against a certain sort of “ trust.”

The intent or objects to be attained by the creation of a railway trust will amply justify it, and ought to be plainly and specifically declared in the trust deed. Among the substantial inducements to such an organization are economy in the operation of the associated lines; the suppression of the competition of reckless and insolvent rivals, including the prevention of rate wars and rate cutting; the prevention of over-building, involving wholesome restraint upon speculative construction,

and recognizing the fact that there is a possible over-production of railways, as well as of sugar or salt; the protection of each road from the encroachments of its rivals; the protection of all the lines in the construction of necessary branches and feeders, and the protection of the public in the construction of new lines; the maintenance of steady rates, leaving the railways to compete in facilities only and not in rates, which is the only healthy competition among common carriers when rates are normal; the protection of the weaker lines, and an arrest of the present tendency toward their absorption by the stronger systems, and finally a stay in the progress now certainly making toward governmental interference and operation. All this and more may be secured by a railway trust honestly and intelligently organized.

If the railways do not control themselves, the federal government will, somehow or other be in control within a dozen years. Our railway managers have conducted themselves frequently, in the matter of competition, in the most puerile and irresponsible fashion, carrying on, at the expense of the stock and bondholders, railway slugging matches, for stock jobbing purposes or for the mere gratification that comes from a fracas. A railway trust of the sort here considered will relegate such antics to the back-yard, because it will put railway operation on the same plane as other sound business enterprises, and make it possible to operate a railway line with a decent regard both

to the interests of the property to be managed and the public to be served.

To come more directly to the details of the arrangement, I suggest that it will not be necessary, or even expedient, to bring into the trust arrangement at first more than a majority of the stock of any road embraced in the scheme. An outstanding minority of the stock, a part of which is in friendly hands, will not, even under a system of cumulative voting, interfere with the control of the property by the trust, and it will serve to secure to the minority such a voice in the management of the road as a minority of right ought to have. The advantages of the trust will probably put a premium upon coming in, and the outstanding shares will continually tend to conversion into certificates. If this be so, the trust will justify itself, if it be otherwise, no harm can come of it, and the minority can, as now, exercise all their rights, without blocking the game.

It will be necessary to divide up the territory to be covered on some natural lines of division, and to create a trust for the railways of each section. Thus, suppose a trust for the trunk lines, another for the territory west and south of St. Louis, another north and west of Chicago, another for the Atlantic seaboard, another for New England and certain of the Canadian lines, another for the south Mississippi valley, another for the territory having its centre at Denver, and finally one for the Pacific coast. These several trusts could all be in-

ter-associated and work together to a common end. In each case there might be created a trust board of twenty-one members including representatives of the stock and bonded interests of the lines included in the scheme, which should act as a committee of the whole in determining the policy of the trust, but to be subdivided into as many committees, of three members each, as there are roads to be operated, no two members to constitute a majority of any two of these subcommittees.

A majority at least of the stock of each of the roads should then be conveyed absolutely to the trust, and the title taken in the names of these subcommittees, the stock of each road to be in the name of a different committee, to be registered on the books of the corporation in their individual names, and to be held by the trust endorsed in blank, for the purposes declared in the deed of trust. For this stock so conveyed to the trust there should be issued, as usual, trust certificates to the several surrendering shareowners. In other words, the usual provisions of a trust arrangement should be entered into between the stockholders constituting the association. This majority would elect the boards of directors and operate the properties pursuant to the provisions of the trust deed and as the interests of the business might dictate. Each road would thus maintain its corporate organization, and carry on its business independently, conforming to all the rules of law affecting its existence and operation, and performing as a com-

mon carrier all its duties to the public, precisely, *as to the public*, as though there were no trust. The public would, therefore, not be heard to challenge the trust.

Dividends should, in every instance, be declared directly on the stock of each road as earned, and paid over, as usual, directly to each stockholder as the stock books declare. Thus the outstanding stock would receive its dividend directly, and the dividends on the stock included in the trust would be paid into the trust and be re-distributed on the certificates. This contrivance would entirely avoid the inhibition of the Interstate Commerce law against pooling, and shut off any possible objection to the trust scheme at this point predicated upon the pooling of earnings or the public function of the railway as a common carrier.

The corporation, *qua* corporation, thus touches the trust at no point. There is created merely a voluntary, unincorporated association between the owners of a majority of the stock of the allied lines. Such an association, it is hardly necessary to say, is absolutely lawful, both in itself and in its purposes. No legislation, either State or federal, can ever be successfully aimed against it, and no hostile court can ever dissolve it as long as the Constitution of the United States and of the several States of the Union are the supreme law. The right to do business in partnership with one's neighbors is guaranteed to the people of these United States not only by our written constitutions,

but by the rules of the common law, and it will not become unlawful in any civilized community in the near future. Upon the invitation of the editor of *The Forum* I have emphasized this view of the legality of trusts in an article entitled "Facts about Trusts,"—published in the September number of that periodical—to which reference is here made for a fuller statement of the points involved.

Two classes only, speaking broadly, will, it is believed, oppose such an association among railway shareowners; namely, (*a*) such railway managers as combine the character of a railway official and stock speculator, and (*b*) the politicians and their victims. But the opposition of neither of these classes will be formidable if the owners of railway property can be united in support of the scheme. It should be carefully canvassed and seriously considered before it is abandoned as impracticable. It is, verily, a feasible proposal, and one which, if carried out intelligently and in good faith, under a declaration of trust skillfully devised, promises more for legitimate railroading in the United States than any other form of railway association and control yet suggested.

II.

THE ATCHISON VOTING TRUST.

The Atchison re-organization now, happily, certain of success beyond a peradventure, includes, by the recent action of the committee in charge, one feature of uttermost importance if the re-organization is really to re-organize and reconstitute that great property, and if the management of the road by its owners is to be perpetuated. Messrs. Kidder, Peabody & Co., through whom the financial operations looking to the re-organization have been conducted, in an advertisement in the commercial newspapers, are calling upon the holders of the new stock to enter into a voting trust for the permanent control of the corporation by the present owners of the securities. The bonded indebtedness of the new organization will be about \$230,000,000, and the par value of the stock \$75,000,000. At the present prices the bonds are worth \$150,000,000, while the stock is worth not more than \$25,000,000. If the new enterprise prosper the value of the bonds is likely to increase more rapidly than that of the stock, so that the ratio of 1-7 of stock interest in the property to 6-7 of bonded interest is reasonably certain not to grow more favorable to the smaller investment.

The stock represents now about one-seventh of

the value of the corporate property, and is not likely to represent more. Under the ordinary conditions this one-seventh of stock-holding interest, or even a scant majority of it, representing not more than one-fourteenth of the value of the property, may elect a board of directors, take absolute and undisturbed possession of the property and manage it for at least a year, without any other than an incidental regard for the interests represented by the other half of the stock and by all the bonds. This is indeed the ordinary course of business in railway management in these latter days. In the case of the Atchison security holders it is not, therefore, strange that an effort should be made to place the management and control of the property—of their property—in responsible and friendly hands, and to build some wall of defense for themselves against the danger of having the board fall into the hands of any speculator or syndicate that, two months before election, might put a million or two into margins on the stock, or eight or ten millions into the stock itself. As the matter would stand without the voting trust, it would be possible to buy or borrow a control of the election in any year, for no greater a price than that, and thus to oust the owners absolutely from the operation of their property. Such financial performances are the amusement of every business day in Wall street. The Atchison management have, therefore, wisely determined to create a voting trust.

About these “trusts” as we know, there are

many pitfalls. There is the C. H. & D. pitfall, and the Reading pitfall, and the Hostetter-Vanderbilt pitfall, and possibly some other not yet catalogued specimens, into one or other of which the unwary voting-trust maker is in danger of stumbling. The Atchison bondholders under the re-organization plan are also stockholders, and if, instead of selling their stock, they place it in the proposed trust, they may perpetuate a lawful control for themselves of the property without sacrificing any advantage incident to the ownership of the shares, except the mere right to vote, which as corporate elections and railway management go is more often a burden than a benefit.

The only practicable voting trust—that is to say the only one yet devised that the courts and the politicians will not undo—is one created by the absolute transfer of the stock to the trustees in exchange for a trustee's certificate in the nature of a declaration of trust. This may be perpetual or for a term. This trust as between each stockholder and the trustees may be personal, and there need be no other contract between trustee and *cestui que trust* than that set forth in the trust certificate. Each stockholder enters into the contract for himself alone, without reference to any other stockholder and without any possible privity with any one else. If one such trust agreement is valid, twenty thousand are equally so, each standing by itself and being the voluntary deed of each stockholder for himself. The legal ownership of the

stock by the trustees would, after the issue of the trust certificates, consist solely in the right to vote, the trust certificate re-conveying to the shareowner all the beneficial interest in the stock. The transaction is, in this view of it, a sort of defloration or emasculation of the stock.

The trustees are then subject only to the general rules of equity which govern trusts. They should be chosen because of their fitness for such a stewardship, and should be absolutely beyond the influence of the certificate holders. They could not elect themselves to office, nor vote themselves remuneration. They ought to have the power to appoint their successors, possibly with the assent of the certificate owners. They would elect the board of directors, which is all that the stockholders acting for themselves ever can do, and their visitorial power would amount to something while that of stockholders amounts to nothing. The ultimate power to control the corporation must be vested in some body of men. This scheme vests it in a responsible board of trustees, instead of in an irresponsible, ignorant and utterly careless body of stockholders. The trustees would be responsible for good management and would be under every motive which actuates men of honor to secure it. No corrupt "ring" of officials could be formed to "run" the property for their personal emolument, and no tried and competent official would be likely to be removed. The trustees should be men of experience in railroad management, and they ought to be largely interested in

the property. Such a plan as is here outlined would place the management of the Atchison in the hands of the men who own it. That is where the control should be in the case of every railroad in the country.

The time is coming in the United States, not only when the looting of insolvent railways in foreclosure will be at an end, but also when the exclusive control of elections by the stockholding interest will give place to a control by the owners of the property. The present system of corporate control has in it the seeds of death. Exclusive stock voting is doomed. With every decade the relative value of railroad stock to railroad bonds declines. The roads are owned more and more by the bonds. It is, therefore, a step in the right direction for the bondholding interest to insist upon a voice in the corporate management, and upon such a renovation of the worn-out machinery now in vogue in corporate elections as to secure it. When the present method of conducting corporate elections was adopted there were no railways, and the corporations then in existence were, in general, small affairs, under the personal management of the owners of their stock. There was no such thing as a bonded debt, nor any such a thing known as liens prior to the stock. We have in fifty years or less created the bonded indebtedness of a thousand railways, and no inconsiderable portion of the entire investment of the country is in railway bonds. But we still go on with our corporate elections just as our fathers did a gene-



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ration and a half ago, and boards of directors of vast systems of railways are elected in the same primitive way in which our grandfathers created a board to manage a cheese factory or a turnpike road between two country towns.

Verily, it is a spectacle for gods and men, when a railway worth a dozen or a hundred millions of dollars is seized at a corporate election by a board of sharks whose aggregate personal, *bona fide* holding of its securities amounts perhaps to seven or eight thousand dollars, and "run" in the interest of whom it may concern, until it is bankrupt, or until some more fortunate or more audacious crowd of "financiers" get it in hand. The stockholder is essentially an irresponsible creature. He knows no duty to his fellow-stockholders, and none to his corporation. His stock is an investment or a "gamble." If it pays he may keep it. If it does not pay he is sure to sell it—if he can. His proxy is delivered by his broker, for a commission, to the highest bidder, and his vote is cast without his instruction, or knowledge, or slightest care. It is not strange that few railway stocks pay dividends, that the greater proportion of these corporations are regularly and systematically plundered by their management, that shrewd men grow rich in Wall street, that railway manipulation and manipulators are in disgrace, and that bondholders are waking up to the propriety of taking a hand in the game.

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